HOUSING MARKET OUTLOOK
Sherbrooke CMA

CANADA MORTGAGE AND HOUSING CORPORATION

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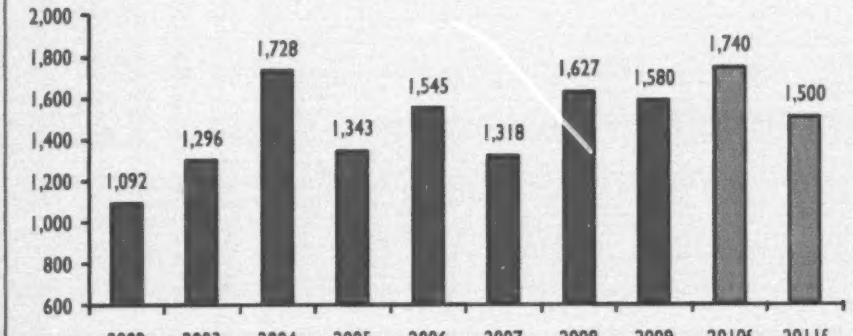
Housing market less robust in 2011[1]

Anticipating an increase in mortgage rates, a number of Sherbrooke households moved up their home purchases into 2010. As this move-up effect has reduced the pool of potential buyers, the year 2011 will be characterized by a slowdown in activity on the Sherbrooke census metropolitan area (CMA) real estate market. Housing starts will drop by 14 per cent next year, after reaching a record high this year (1,740 units). With the resale market having already begun to decelerate in 2010, MLS® sales, for their part, will remain relatively stable next year (1,765 units).

Figure 1

Housing Starts – Sherbrooke CMA



Source: CMHC f: CMHC forecasts

[1] The forecasts included in this document are based on information available as of October 8, 2010.

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Employment to increase in 2011

As was the case in most areas of Quebec, the Sherbrooke CMA regained all the jobs that were lost during the last recession. The uncertainty about the economic recovery will limit hiring this year.

Still, in our reference scenario, we anticipate that the gradual improvement in the global economic conditions will enhance the job prospects in the Sherbrooke area in 2011. In addition, with the decreasing uncertainty on the markets, the private sector should now also fuel the economic growth more significantly. In 2011, employment in the Sherbrooke CMA will reach 85,500 jobs, up 1.5 per cent from 2010.

Mortgage rates

On September 8th, the Bank of Canada increased the Target for the Overnight Rate from 0.75 per cent to 1.00 per cent. This is the third 25 basis point increase since April 2010, when the rate was at a historical low of 0.25 per cent. With the overnight rate expected to remain flat, mortgage rates, particularly short term mortgage rates and variable mortgage rates, are also expected to remain steady at current levels.

According to CMHC's base case scenario, posted mortgage rates will remain flat in the second half of 2010 and in 2011. For 2010, the one-year posted mortgage rate is assumed to be in the 3.0 to 3.7 per cent range, while three and five-year posted mortgage rates are forecast to be in the 3.2 to 6.1 per cent range. For 2011, the one-year posted mortgage rate is assumed be in the 2.7 to 3.7 per cent range, while three and five-year posted mortgage rates are forecast to be in the 3.5 to 6.0 per cent range.

Rates could, however, increase at a faster pace if the economy ends up recovering more quickly than presently anticipated. Conversely, rate increases could be more muted if the economic recovery is more modest in nature.

Net migration to rise slightly

Quebec's net migration should reach 50,000 persons (+1 per cent) in 2010 and then 52,000 persons (+4 per cent) in 2011. The gains in international net migration will therefore exceed the losses recorded in interprovincial net migration.

The demographic changes observed at the provincial level will no doubt have an impact on net migration in the Sherbrooke area. Given that the CMA receives about 2 per cent of the immigrants arriving in Quebec each year, a greater number of new residents will settle in Sherbrooke. And, as was the case in 2009, the Sherbrooke area will continue to welcome many people from other areas of Quebec, thereby improving net migration.

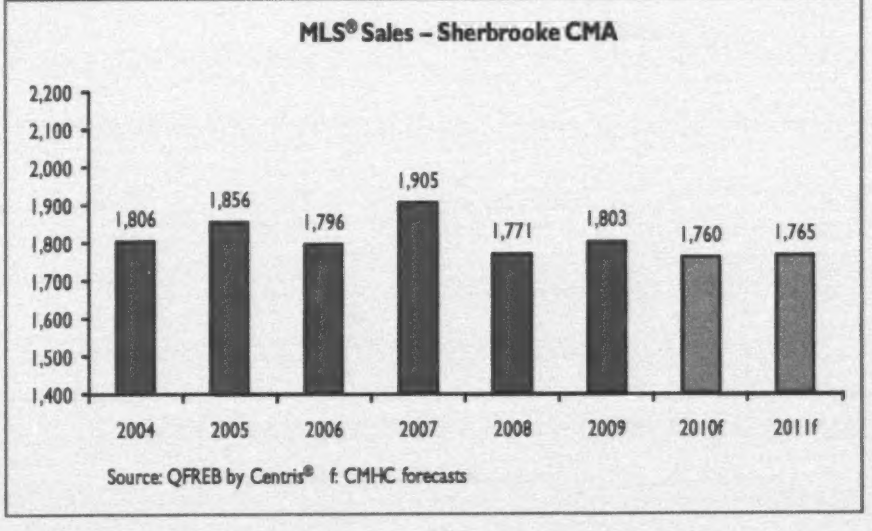
For all these reasons, net migration in the Sherbrooke CMA should reach 1,600 people in 2010 (+3 per cent) and continue to rise in 2011, this time by slightly over 1 per cent. While the government targets should bring about an increase in the number of immigrants in the area, Western Canada will attract workers from Quebec and from the Sherbrooke area in particular, thanks to the improved economic conditions of that part of the country.

These modest increases will therefore help support demand for housing (especially rental dwellings) in the Sherbrooke CMA in 2011.

MLS® sales to remain stable in 2011

The resale market in the Sherbrooke CMA evolved in two different directions in 2010. After increasing by 17 per cent in the first quarter, MLS® sales[2] decreased by over 10 per cent in the second and third quarters.

Figure 2



[2] Source : QFREB by Centris®

This slowdown was mainly due to the end of the move-up effect mentioned earlier. This downward trend will continue in the last quarter, such that there should be a total of 1,760 MLS® sales in 2010 (2 per cent), their lowest level since 2002.

In 2011, the economic fundamentals suggest that resale market activity will remain relatively stable. While MLS® sales will benefit from a more favourable job market, other factors will have a negative impact on the resale market next year.

First, the home purchase move-up effect observed at the beginning of 2010 will considerably reduce the pool of buyers next year, causing a slowdown in demand for resale properties. Second, the possible increase in mortgage rates that will occur in 2011 will limit the number of households wanting to buy a home. Third, various tax measures may reduce consumers' disposable income next year, further moderating housing demand. Despite this context, we nevertheless estimate that MLS® sales will remain stable next year, at 1,765 units. While the labour market performance in the CMA will offset these negative elements, it is important to mention that a volume of 1,765 MLS® transactions still represents a historically low level.

On the supply side, active MLS® listings have been growing steadily in the Sherbrooke area since the middle of 2010. This was when demand softened on the resale market. As no major changes are expected on the demand side of the MLS® market next year, active listings will continue to rise in 2011, attaining 1,350 units (+1 per cent). As a result, a larger choice of existing homes for sale will be available to households seeking to buy a property next year in the CMA.

The combination of these factors (stable demand and greater supply) will favour buyers next year. The market will still remain balanced in 2011. Consequently, the average price will register a smaller gain (+2 per cent) and reach $204,000 in 2011.

While these results suggest that the average price will rise in the CMA in 2011, it should be noted that the situation will be slightly different in two of the large sectors of the CMA, namely, the cities of Sherbrooke and Magog[3]. It is important to note that, contrary to the overall CMA, the Magog area market remains favourable to buyers. Therefore, the average price should rise less significantly there than in the CMA.

Housing starts to decrease in 2011

As of September 30, 2010, foundations had been laid for 1,383 units in the Sherbrooke CMA this year. At this rate, we expect that the Sherbrooke CMA will end 2010 with 1,740 housing starts (+10 per cent), the highest level ever recorded in the history of the CMA[4]. As well, contrary to other years, the 2010 numbers cannot be explained by the many housing starts normally attributable to the construction of one or more retirement homes. This means that the vast majority of the dwellings built this year were intended for the freehold and condominium markets, a sign that there was a strong movement to homeownership. Construction was in fact very strong during the first months of 2010, demonstrating that a move-up effect also occurred on the new home market.

That being said, in 2011, 1,500 units will be started, down 14 per cent from 2010. The reasons behind this decrease are mainly the same as those we mentioned for the resale market: the home purchase move-up effect in 2010 that reduced the pool of potential buyers, the possible increase in mortgage rates and the various tax measures that will reduce consumers' disposable income.

It should be specified that the decrease in residential construction will affect all housing types in the Sherbrooke area next year. Firstly, single-detached housing starts will drop by 2 per cent in 2011, to 590 units. At first glance, this may seem like a small decrease, but it is important to point out that, following a recessionary period, residential construction is usually concentrated on more affordable housing types (semi-detached and row homes, as well as condominiums). Since single-detached homes have already begun losing ground to these less expensive homes in 2010, the anticipated decline in 2011 will be more limited however. We should also mention that the expected rise in listings on the resale market will increase the supply of existing single-detached houses for sale in the CMA. There should consequently be fewer households opting for a new single-detached home because of a lack of choice on the resale market.

Secondly, the volume of new semi-detached and row homes will also decrease in the Sherbrooke area next year, with about 225 units getting under way, compared to nearly 300 this year–a record. This drop will be mainly due to the decreasing pool of potential buyers but will be all the greater on account of the high level of activity recorded for this type of

[3] To compare the average prices between the CMA and the cities of Sherbrooke and Magog, we used the average prices of single-family homes.

[4] Since these data began being compiled.

housing in 2010. The same observation can be made about condominiums, as such starts will fall from 150 units in 2010 to about 100 in 2011.

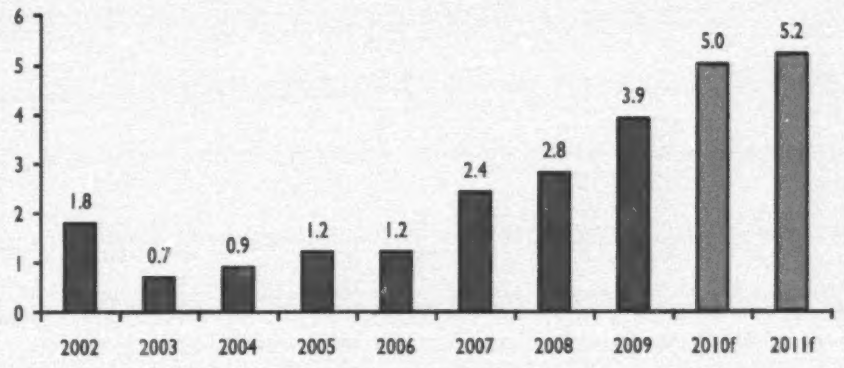
Lastly, foundations[5] should be laid for fewer rental apartments next year in the Sherbrooke CMA. As will be explained in the last section of this report, the rental housing vacancy rate has been steadily increasing for the past three years in the CMA. Among Quebec's major urban centres, the capital of the Eastern Townships has the highest proportion of vacant rental units, and this trend should continue in 2010. The construction of a large volume of affordable housing units in the CMA over the last few years probably prompted many renters to become homeowners, which explains the successive vacancy rate increases.

Next year, 500 rental apartment units will therefore be started, compared to nearly 650 this year. Consumer preferences for newer, more modern apartments and social housing projects are factors that will limit this decrease. Finally, let's mention that no major retirement housing projects are expected to get under way in 2011. It should be noted that several retirement homes were built in the CMA these past few years, at a time when demand was slowing[6]. This market is therefore currently in an absorption phase.

As an indication, we should point out that the expected drop in housing starts is in line with net household formation in the Sherbrooke CMA. In fact, it is generally accepted that, over the medium and long terms, housing starts closely follow net household formation. These past few years, net household formation in the Sherbrooke CMA has varied between 1,000 and 1,200 households per year, while housing starts have ranged from 1,300 units to 1,700 units annually, well above demographic needs.

Figure 3

Rental Apartment Vacancy Rate (%) – Sherbrooke CMA



Source: CMHC f: CMHC forecasts

Rental market conditions to soften

According to the results of the latest Rental Market Survey conducted by CMHC in October 2009, the rental apartment vacancy rate[7] increased again in the Sherbrooke CMA. After climbing by 0.4 of a percentage point in 2008, to 2.8 per cent, this rate continued to rise in 2009, reaching 3.9 per cent. The rental market has now been easing more significantly for the past three years in the Sherbrooke area, mainly as a result of a strong shift to homeownership. It should be mentioned that the increase in the size of the rental housing stock also contributed to the rise in the vacancy rate, but to a lesser extent.

As was already substantially demonstrated earlier, this trend continued in 2010 in the Sherbrooke CMA, thereby curbing demand for rental units. It should be recalled that starts of more affordable housing types (semi-detached and row homes, as well as condominiums) will likely record the greatest increases this year. Given the low mortgage rates and the availability of these housing types on the market, a number of Sherbrooke renters very likely became homeowners this past year. In addition, while demand decreased, supply increased with the arrival of many new units on the market. Under these conditions, it is not surprising to see more and more "For Rent" signs in the Sherbrooke CMA. The vacancy rate will therefore reach 5 per cent in 2010, up 1.1 percentage points over 2009. For its part, the average monthly rent for two-bedroom apartments will reach $560 this year.

In 2011, the weaker movement to homeownership will allow demand for rental accommodations to pick up. However, supply will surge again, with the expected addition of a number of

5 Rental apartments include duplexes and co-operative housing units.
6 In fact, many of the people now aged 75 years or older, who account for a significant share of retirement home clients, were born during the Great Depression of the 1930s, a period when the birth rate was lower.
7 Privately initiated rental apartment buildings with three or more units.

new structures to Sherbrooke's rental housing stock[8]. All in all, the growth in net migration and the improvement in youth employment observed in the CMA are the main factors that will support demand on the rental market over the coming year. The vacancy rate should therefore reach 5.2 per cent next year, up slightly over 2010.

[8] There is usually a lag between the addition of new rental apartments and changes in the vacancy rate. A high level of rental apartment starts could therefore still be observed, despite the steady rise in the vacancy rate.

Forecast Summary Sherbrooke CMA (1) Fall 2010							
	2007	2008	2009	2010f	% chg	2011f	% chg
Resale Market							
MLS® Sales	1,905	1,771	1,801	1,760	-2.3	1,765	0.3
MLS® Active Listings	1,144	1,376	1,321	1,335	1.1	1,350	1.1
MLS® Average Price ($)	$183,120	$187,669	$193,245	$200,000	3.5	$204,000	2.0
New Home Market							
Starts:							
Single-Detached	666	802	668	600	-10.2	590	-1.7
Multiples	652	825	912	1,140	25.0	910	-20.2
Starts - Total	1,318	1,627	1,580	1,740	10.1	1,500	-13.8
Average Price ($) - excluding Magog:							
Single-Detached	$168,702	$179,200	$219,732	$222,000	1.0	$225,000	1.4
New Housing Price Index (% chg) (Que.)	4.2	5.0	3.1	n.a.	-	n.a.	-
Rental Market - excluding Magog in 2006							
October Vacancy Rate (%)	2.4	2.8	3.9	5	-	5.2	-
Two-bedroom Average Rent (October) ($)	$529	$543	$553	$560	-	$565	-
Economic Overview							
Mortgage Rate (1 year) (%)	6.90	6.70	4.02	3.47	-	3.20	-
Mortgage Rate (5 year) (%)	7.07	7.06	5.63	5.59	-	5.20	-
Annual Employment Level - excluding Magog	84,100	83,000	83,500	84,300	1.0	85,000	0.8
Unemployment rate (%) - excluding Magog	6.2	6.1	6.9	7.7	-	7.9	-
Net Migration - excluding Magog	892	1,467	1,559	1,600	2.6	1,625	1.6

MLS® is a registered trademark of the Canadian Real Estate Association (CREA)

(1) According to Statistics Canada's new definition, the Sherbrooke CMA now includes the municipality of Magog. Statistics have been adjusted except where indicated.

Source: CMHC (Starts and Completions Survey, Market Absorption Survey), adapted from Statistics Canada (CANSIM), QFREB by Centris®, Statistics Canada. CMHC Forecast (2010-2011).

NOTE: Rental universe = Privately initiated rental apartment structures of three units and over

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